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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM 1940

No. 31

AMERICAN UNITED MUTUAL LIFE INSURANCE COMPANY,

Petitioner,

vs.

CITY OF AVON PARK, FLORIDA

Respondent.

BRIEF OF RESPONDENT

ROBERT J. PLEUS,

Attorney for Respondent.

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BRIEF OF RESPONDENT

Statement of the Case

The City of Avon Park, located in Highlands County, Florida, which is in the South Central portion of the State, had issued its general obligation coupon bonds bearing an average six per cent interest rate to such extent that on July 1, 1937, there was outstanding a total of $1,223,751.76. Of this amount past due and unpaid interest to such date amounted to $358,251.76, the balance of said amount being represented by principal, of which $183,000 had matured. (R. 87).

There is no dispute that the City was hopelessly unable to pay its debts as they matured. Many of the past due items

had already been reduced to judgment, and the City was harassed by litigation (R. 11-13). The assessed valuation had fallen from its peak in 1927 of $9,814,220 to $2,504,087 in 1937 (R. 7). This was brought about, not only by the crash of the now famous "boom", but likewise general economic conditions (R. 116).

Finding itself in this plight, the City entered into a contract under date of July 17, 1937 with one R. E. Crummer & Company, wherein and whereby the said company agreed to "endeavor to accomplish a refunding, by a par for par exchange, of the" said funded indebtedness (R. 28). The said contract set forth the indebtedness sought to be refunded and the terms thereof. In general it was contemplated that the refunding bonds to be authorized and issued by the City would bear a scaling interest rate beginning at 2% for the first two years, 3% for the next succeeding six years, 4% for the next succeeding seven years, and 5% thereafter At no time was the interest rate ever to reach the original six per cent, which latter rate prevailed as to all original bonds except one $30,000 issue of June 1, 1916 (R. 28). The new bonds were to be optional, the tax levy requirements for interest and sinking fund purposes were set forth, and the City obligated itself to take such action as might be necessary to consummate the refinancing program involved. The costs of such program were to be borne by assessing charges against the security holders who would accept the refunding bonds (R. 36), and the contract was to run for a period of three years (R. 36).

It must be remembered that the outstanding original bonds were all non-callable, and bankruptcy action was not available to the City and its creditors at such time because of the decision of this Court in the case of *Ashton vs. Cameron County Water Improvement District*, 298 U. S. 513, 56 Sup. Ct. 892, 80 L.

Ed. 1309, decided May 25, 1936, holding unconstitutional the original Municipal Debt Adjustment Act, 48 Stat. 798, 11 U. S. C. Sec. 301. The present Act under which these proceedings are brought was not enacted until August 16, 1937, 50 Stat. 654, 11 U. S. C. Sec. 401, et seq; and it was not until the decision of this Court in *U. S. vs. Bekins*, 304 U. S. 27, 58 Sup. Ct. 811, 82 L. Ed. 1137, decided April 25, 1938, rehearing denied May 23, 1938, that effective procedure under the Bankruptcy Act was assured.

Thus it was that the contract of July 17, 1937, was entered into wholly upon the basis of a best efforts arrangement looking toward a voluntary exchange through the efforts of the Fiscal Agent in persuading the holders of the outstanding non-callable bonds bearing a high interest rate to voluntarily relinquish the same for lower interest rate bonds having a longer maturity. There was no guarantee on the part of the Fiscal Agent, and it merely agreed to endeavor to accomplish the refunding on the basis agreed upon.

It immediately set to work to accomplish the desired result, and two days before the decision of this Court in the Bekins case, supra, the City promulgated what was known as a "Refunding Plan" (R. 16). The said refunding plan was adopted wholly separate and apart from the contract with the Fiscal Agent, and merely incorporated therein the terms of the offer of settlement and adjustment made thereby to creditors. The plan set forth the manner in which the expense of the refunding operation was to be paid, and the same was to be done by means of an assessment against "bondholders participating in the plan". Such assessment was to be two per cent of the principal affected, with a ratable portion thereof in case of bonds of less than $1,000.00 denomination (R. 24). Such assessment against bondholders was solely for the purpose of defraying the necessary expenses of the Fiscal Agent, and to

reimburse it for its services and the expenses which it had agreed to defray insofar as the City was concerned (R. 23). Thus, when the original contract was signed, bankruptcy action was neither contemplated nor certain under existing laws and decisions.

Following the decision of this Court in the Bekins case, supra, and due entirely to the non-consent of certain recalcitrant, litigating creditors, of whom the Petitioner is one, (R. 195) bankruptcy action was taken by the filing of a petition on August 15, 1938. The refunding plan, adopted April 23, 1938, was made the basis of the original petition (R. 16).

In objection to the proceedings appeared certain creditors, among them the Petitioner here, and the said Petitioner filed its answer (R. 63), and its amended answer (R. 70) to the original petition, and said answer presented the sole issues and objections which Petitioner raised in the Court below. Those issues and objections are now sought to be enlarged and expanded, and it is submitted that Petitioner is bound thereby.

Furthermore, in order to remove the objections so raised, a modified plan of refunding was adopted by the City on February 3, 1939 (R. 86) and submitted to the Court by petition of the City on February 28, 1939 (R. 82), and allowed to be filed by the Court by order dated February 28, 1939. To such modified plan, and the petition submitting the same, no objections were filed by Petitioner, nor was any answer filed thereto. There is, therefore, at the outset the serious question presented of whether or not the Petitioner has any standing to object to the said modified plan. Testimony was taken, and a full and complete hearing had before the Special Master, and his report filed (R. 101, et seq.). The Master made findings of fact and announced conclusions of law (R. 218, 225); exceptions to his report were filed by Petitioner (R. 231). Such

exceptions centered around the method of compensating the Fiscal agent and its right to be considered a creditor entitled to consent to the plan. Thus, no question was raised as to the validity of the fiscal agency contract, or its bearing upon the plan; nor was any question raised that the compensation allowed the Fiscal Agent for its services and expenses was exorbitant.

Upon the Special Master's report coming in, the District Court confirmed the plan by interlocutory decree dated June 19, 1939 (R. 237). Appeal was taken to the Circuit Court of Appeals of the Fifth Circuit (R. 251), and by decision rendered January 31, 1940, 108 F. (2) 1010, the District Court was affirmed (R. 267).

Argument

We submit that because of the utter inconsistency between specifications of error numbered 1 and 2, it is impossible to argue them separately. Joining the two together, we find that Petitioner asserts first, that the fiscal agency contract between City of Avon Park and R. E. Crummer & Company is an integral part of the plan, and being void under the holding of the Supreme Court of Florida in the case of *Taylor vs. Williams*, ...Fla....., 195 So. 175, 195 So. 181, 196 So. 214, such plan could not be confirmed; and second, that because of the agency relationship created by the void contract, the Fiscal Agent was disabled from having its securities counted in determining the required percentage of consents, and was likewise disabled because of such agency from receiving compensation in the manner provided in the plan.

The utter inconsistency of these two positions is readily apparent: If the fiscal agency contract is void, as contended for by Petitioner, no agency relationship was created thereby, and

the purported fiscal agent is nothing more than a mere creditor; and as such creditor is entitled to compensation for services rendered in connection with the development and consummation of the bankruptcy proceedings.

In other words, the whole gravamen of Petitioner's complaint under the second assignment is that because of an agency relationship the securities of the Fiscal Agent could not be counted, and because of such agency relationship the Fiscal Agent was precluded from its compensation in the manner provided in the plan. The question of the purchase of the securities and the speculative feature so much indulged in by Petitioner will be discussed later.

The Act, as it read at the time of the Interlocutory Decree herein, is clear as to the allowance of compensation. It specifically authorizes the Judge to

> "allow * * * the actual and necessary expenses incurred in connection with the proceeding, including compensation for services rendered and expenses incurred in obtaining tne deposit of securities and the preparation of the plan, whether such work may have been done by the petitioner or by committees or other representatives of creditors, and may allow reasonable compensation for the attorneys or agents of any of the foregoing, and may apportion the amount so determined among the parties to the proceedings as may be just: *Provided, However,* That no fees, compensation, reimbursement, or other allowances for attorneys, agents, committees, or other representatives of creditors shall be assessed against the petitioner or paid from any revenues, property, or funds of the petitioner, except in the manner and in such sums, if any, as may be provided for in the plan of composition." 11 U. S. C. 403 (b).

Thus, there can be no question that compensation may be paid to any person, whether an agent of the Petitioner, or

an agent or representative of creditors, or a creditor himself, for services rendered and expenses incurred in connection with the proceedings. The proviso, as stated by the Circuit Court of Appeals, Fifth Circuit, in *Vallette vs. City of Vero Beach*, 104 F. (2) 59, 124 A. L. R. 686, (Cert. Den. 84 L. Ed. 87, 60 Sup. Ct. 110):

> "does indicate that it is not inappropriate for the plan to deal with the matter of compensation, the allowance being at last the Act of the judge. The vote of the creditors upon the plan does not at all bind the judge in finally allowing compensation."

The amount of debt involved aggregated $1,223,751.76. The compensation allowed and approved by both the lower courts was to be apportioned against the creditors by assessing a four per cent charge based upon the principal items only. Such principal items aggregated $865,500.00, and such four per cent charge would aggregate $34,620.00 (R. 201). Such charge amounts to approximately 2.8 per cent of the total debt involved in return for which the Fiscal Agent defrayed all expenses incident to the refinancing operation, prepared the plan, obtained the consents, furnished special counsel in the bankruptcy proceedings, which have now gone through two lower courts to this Court, defrayed the expenses of printing and validating the refunding bonds, and obtaining the opinion of general market attorneys, and likewise paid the expenses of certain special litigation to determine the taxability of certain lands due to an extremely complicated situation brought about by the change in area of the City. (R. 35, 163, 199).

The original plan provided for the sale of the accrued interest items at the rate of 33⅓ per cent of face to the Fiscal Agent (R. 25), which, when refunded into the new refunding bonds, would be held by the Fiscal Agent subject to purchase by the City at not exceeding 50% of the face thereof for

the first six months, 60% for the next succeeding six months, 70% for the next six months, and 75% for the next six months.

Due to the ruling of the District Judge in the Vero Beach case, (as referred to by the Circuit Court of Appeals in *Vallette vs. City of Vero Beach,* supra,) the plan in the case at bar was changed to meet that objection (R. 197), and as so modified and confirmed, it provided for compensation of the Fiscal Agent to be four per cent of the principal debt, with the right of any creditor who desired so to do, to sell to the Fiscal Agent his interest accruals at the agreed figure of 33⅓ per cent of face; and in such latter event, the charge against him was reduced from four per cent to two per cent of the principal of his bonds (R. 99). In order to protect the interest of the unit in its right to a guaranteed purchase price (R. 198) for such securities as could be bought by the proceeds of delinquent taxes, the interest items were to be escrowed and made available to the City for the same period of time as contemplated by the original plan, and the sale price was to be the same. (R. 97). Thus was provided the mechanics whereby the interest accruals could be, in effect, offset against the delinquent tax bill which the City had against its taxpayers on account of taxes levied for the years 1936 and prior (R. 95); and at the same time providing the means whereby, wholly at the voluntary option of each particular creditor, he would be given the right to liquidate at an agreed cash figure his delinquent interest claim—such price being guaranteed by the Fiscal Agent, and such price being the approximate cash market value thereof. (R. 199).

Hence, we have present the confirmation by the two lower courts of a modified plan of composition which, in effect, allows compensation in the amount of $34,620.00 on account of all costs and expenses incident to the settlement of a debt problem involving $1,223,751.76; which compensation is the maximum that can be realized by the Fiscal Agent. A particular

creditor may agree to sell to such Fiscal Agent at an agreed price, certain interest items which such creditor may own; in which event, if such securities increase in value, "profit" may be derived by the Fiscal Agent; but in the event of a drop in market value, the Fiscal Agent might suffer substantial loss. However, the creditors, not only have the option given them of realizing cash at the approximate market value of their delinquent securities, but they likewise have the right to enforce the payment of the agreed price. (R. 199.) Such creditors are under no coercion to sell to the Fiscal Agent, but may sell to anyone else, or may retain the interest items for themselves; but the Fiscal Agent has assumed the responsibility of guaranteeing the price that it will pay. Thus, whatever element of "speculation" there may be is presented, first, at the option of each particular creditor as to the items he owns, and second, is nothing more nor less than the speculation which could be brought about by any person going into the open market and purchasing securities. The allowance of the compensation has nothing to do with whatever speculative feature as to a rise or fall in the market there may be. The hearing covered the element of compensation, the master approved it, the District Judge confirmed and the Circuit Court of Appeals affirmed. Even in this Court, there is no criticism whatsoever of the amount that is the maximum that will be realized. Only as to the so-called speculative feature is complaint made, and when it is seen that that speculation is subject to either profit or loss and is a privilege open to all creditors alike by resort to market operations, such criticism falls of its own weight.

It is extremely significant that when the Chandler Act, approved June 22, 1938, c. 575, sec. 1, 52 Stat. 840, was adopted, there was placed in Section 249, Chapter X, on Corporate Reorganizations, the provision disabling a person from

receiving compensation in proceedings under said Chapter X, unless such person should file with the Court a statement of his ownership in claims and securities acquired or transferred by him after the commencement of such proceeding. This section likewise provided that no compensation or reimbursement would be allowed a representative or fiduciary who at any time after assuming to act in such capacity had purchased or sold claims or stock of the debtor without the prior consent or subsequent approval of the Judge. There is no such provision in Chapter IX having to do with municipal debt adjustments. Likewise Chapter IX was amended by said Chandler Act, and was subsequently amended in certain particulars by Act of March 4, 1940, c. 41, Section 1, 54 Stat. . . . . , and again by H. R. 9139, 76th Congress, Third Session, approved June 28, 1940. In none of the amendatory acts was any such provision as contained in said Section 249 inserted.

But even if Section 249, supra, is a statutory declaration of either equity or public policy, then the answer is that the entry of the interlocutory decree and the allowance of compensation, following the submission of all the facts involved, complies with all elements requiring the subsequent approval of the Judge.

The logic of the Circuit Court of Appeals in the Vallette case cannot be denied, namely: That the agent's acquisition of the interest items comes into play only at the option of the holder who would rather take cash and reduce his assessment than to speculate himself, that such holder has his choice and that all are assessed without discrimination. Likewise, the same court, in constructing Section 83 (b), stated:

> "The Act itself, allows expenses and compensation to be fixed for persons having all sorts of relations to the case. No disqualification to claim compensation appears."

We find neither in the Act, nor any decisions an inhibition against one creditor buying securities in good faith while they are free floating securities in the open market for the purpose of giving a consent in a bankruptcy composition. Therefore, there must be something more than mere ownership by purchase prior to the bankruptcy proceedings. It is stated in the brief of opposing counsel that the record is silent as to when the judgments were bought (Brief, page 22), but if such is the case, such silence is due to Petitioner's own fault in view of the fact that the Special Master specifically directed each claimant to supply the assignment of judgment included in its claim (R. 109) the same were supplied but omitted from the record by the directions filed by Petitioner. Such assignments showed just the contrary of what opposing counsel now asks this Court to presume and showed that all such judgments were purchased prior to the institution of the bankruptcy proceedings, and in some cases even prior to the contract itself. Not only do the omitted portions of the record show this to be a fact, but the record itself (R. 202) shows conclusively that the judgments were purchased "at a time when bankruptcy was not contemplated and it appeared to us that one of the best ways to assist in the accomplishment of the results sought was to purchase those judgments * * *." (See also R. 169, 171). In fact, in said brief, counsel admits that the consents to the plan were executed by the agent, such consents being those which allowed the institution of the suit and which were attached to the petition, but which likewise were omitted from the record at the instance of Petitioner. (R. 254.) The presumption, therefore, which counsel asks this Court to draw is not only false in fact, as such counsel should know, but is contrary to the record itself and to the full record had counsel seen fit to bring it all before this Court. Therefore, we shall assume that such judgments were all bought as free floating securities in the open market subject to purchase by

anyone prior to the bankruptcy proceedings. The reason why they were bought by this particular creditor is immaterial, but if deemed by the Court to be material, the same is amply explained in the fact that the judgments were rendered on past due items, were subject to enforcement writs requiring tax levies, constituted a hazard to the City, and to the ultimate fulfillment of the refunding operation without the coercive power of bankruptcy proceedings. In fact the same were bought at a time when it was not deemed possible to secure bankruptcy protection, and it appeared wise to accomplish the results sought by means of getting the recalcitrant claims into friendly hands. Only long after such acquisition by the Fiscal Agent, or other cooperating creditors, was bankruptcy even considered (R. 202). Nor is there any element of concealment or fraud in view of the facts that the consents and proofs of claim have been filed by the real and true owners on all the items involved. It now happens that because of such acquisition of securities, it is possible for the required per cent of creditors to be obtained and one creditor who holds a nominal amount of the indebtedness complains of having to pay his just proportionate part of the expense of the operation; and it must be remembered that he pays no part of that which is assessable against the Fiscal Agent's securities because each creditor pays a fixed unit prorata portion of the aggregate compensation allowed. Therefore, contrary to the assumption of counsel for Petitioner that the Fiscal Agent purchased these claims in order to obtain acceptances to the plan and enable the City to show the consent of the required percentage, the record is conclusive that it was done solely in order to preclude the necessity of bankruptcy action, or that it was done at a time when bankruptcy action was not contemplated or available.

Nor do we understand that any specification of error contemplates the basis for an argument that the debt structure

sought by such plan to be rehabilitated will be unsound, impossible of fulfillment, or unworkable. Even assuming that before a plan can be confirmed there must be a guarantee of performance, it is submitted that the record is conclusive that the plan devised follows pretty well plans in other similar taxing units which have worked, and the ability of the Fiscal Agent, and its experience and success in handling these refunding operations are amply established (R. 193, 198). See Vero Beach case, supra.

Concerning any discrimination in favor of the moneys arising out of the so-called Meredith writ, such is amply covered by the record to the full satisfaction of any reasonable person. Florida has what is known as the "first come, first served" rule, which allows a creditor to impound and have applied to his securities moneys on hand, or allows him to obtain an earmarked tax levy to the exclusion of all other creditors, and regardless of the ability of the unit to pay all. Thus, it was necessary to obtain such writ to earmark and protect the funds, not one dollar of which ever reached the Fiscal Agent or the relators in the mandamus case, and all of which is still held by the City to be used in meeting the first year's appropriation under the modified plan (R. 200). Concerning any failure on the part of the City to make levies for recalcitrant creditors, it may be stated that the enforcement of those writs was entirely up to each such creditor and to state that such judgment creditors had "been unable to compel the City to perform the mandates of the courts requiring the levy of taxes" is a most bold assertion on the part of opposing counsel as to the impotency of legal process.

We cannot refrain from calling the Court's attention to the assertion of opposing counsel in his brief on page 5 that

> "the testimony of the Vice-President of the Fiscal Agent (pp. 169, 170, 177, 203 and 204) establishes beyond doubt that one or both of the corporations

> owned a substantial portion of these claims at the time the Fiscal Agency contract was entered into with the City. Some of the bonds, coupons and judgments owned by the two corporations were purchased after the contract was made (p. 170)."

and the statement made on page 22 of his brief that

> "Hence, it is reasonable to assume that the Fiscal Agent purchased these claims in order to obtain for the City acceptance of the Plan, and enable the City to show the consent of holders of more than two-thirds of the claims, as required by statute."

Likewise, his statement on page 22 that

> "these judgments must have been bought after bankruptcy proceedings were instituted, * * *."

It is impossible to reconcile these totally inconsistent statements. The record shows that none of the claims or judgments was bought after bankruptcy action was even contemplated. (R. 169, 171, 202).

However, we do not admit that the decision in the Taylor case, supra, is a holding that a fiscal agency contract of the type involved in the suit at bar is invalid or unenforceable. On the contrary, a reading of all the opinions in the Supreme Court in the Taylor litigation will demonstrate the contrary. The Taylor case involved a county and not a city, and the specific distinction between them is made by the Supreme Court; the Taylor case did not hold that under the contract involved was the Fiscal Agent "managing or controlling any of the official functions involved in the issuing of refunding bonds"; nor did it hold that such agent could not be employed "for services in no wise official in their nature", nor did it deny compensation therefor; but it merely denied the right to use interest and sinking fund moneys in payment of such compensation; and finally, the Taylor litigation was on interlocutory

appeal, and the final decision of the Supreme Court merely remanded it to the Circuit Court for the making up of proper issues and the taking of testimony. However, we strenuously urge again that the contract is not material and the compensation allowed is by virtue of the Bankruptcy Act, and not by virtue of any contract for the very obvious reason that the Fiscal Agent and the City could not contract together, and by such contract, impose obligations on third parties.

The cases cited in Petitioner's brief are either inapplicable or clearly distinguishable:

In Re E. T. Kennedy Co., 136 Fed. 451, is inapplicable.

In Re Weintrob, 240 Fed. 532, involved claims that were purchased at full value after bankruptcy and the fact showed that it was a collusive device to aid the bankrupt to force a twenty-five per cent settlement in the composition proceedings.

In Re M. & H. Gordon, 245 Fed. 905, involved an agreement on the part of the bankrupt that constituted a preferential payment out of the assets of the bankrupt, to the detriment of other creditors.

In Re Kinnane Co., 221 Fed. 762, again involved a priority or preference in the bankrupt's estate.

In Re Griffith Stillings Press, 244 Fed. 315, the plan of composition was confirmed.

Fairbanks vs. Amoskeag National Bank, 38 Fed. 630, involved a secret agreement on the part of the bankrupt to pay an additional sum to one creditor, and the assignment of the claims to such creditor for the purpose of voting them had been fraudulently concealed.

We ask the Court to take judicial notice of the fact that Bondholders' Committees are generally composed of the principal creditors or representatives of corporate creditors who desire a centralized management for the purpose of, in many instances, effecting a reorganization; and that Chapter IX specifically allows compensation to such Committees or representatives of creditors for services and expenses in connection with the proceedings. The plan appropriately makes provision for the pro-ration of such costs among creditors; its allowance is, in final analysis, the act of the Court; it does not arise, nor is it payable by virtue of contract, and it is grounded upon specific statutory authority. Nor is there anything in Chapter IX, nor in equity or public policy that precludes a creditor who has rendered a valuable service from receiving compensation merely because he is such creditor. It is submitted, therefore, that specifications of error numbered 1 and 2 are without foundation.

With reference to Specification of Error No. 3, it should be conclusive to quote from the decision of the Circuit Court of Appeals in the Vallette case, supra, upon the authority of which the Circuit Court of Appeals affirmed the case at bar, wherein it was specifically held:

> "The proviso, however, does indicate that it is not inappropriate for the plan to deal with the matter of compensation, the allowance being at last the act of the judge. The vote of the creditors upon the plan does not at all bind the judge in finally allowing compensation."

> "As to amount, we are not prepared to overrule the allowance of the judge. As to its imposition on the creditors as a proportionate assessment, that is authorized by the words of the Act above quoted."

Thus, there is nothing in the opinion in the Vallette case in conflict with the decision of this Court in *Case vs. Los Angeles Products Co.*, 84 L. Ed. 22. (Adv. Sh.) The above quotations show specifically that while the Court considered the fact that the amount of the allowance, as set forth in the plan, had been approved by the vast majority of the creditors, it was not controlled thereby; but, on the contrary, it specifically adjudged that the vote of the creditors does not bind the Court, that the allowance is at last its act, and that its imposition as a proportionate assessment is authorized by the Act. It is significant indeed that this creditor now complaining holds barely four per cent of the indebtedness affected by the plan.

Nor is it true that under the fiscal agency contract would the Fiscal Agent have any control over the financial affairs of the City, because if counsel is correct, such contract is void; and if not, it has expired by its own limitation; and furthermore, such contract never contemplated any such thing, as a fair reading thereof will quickly disclose.

If Petitioner herein is fearful of the effect of speculation by the agent, then all it needs to do is to decline the option, accept the refunding bonds at par for its unliquidated interest items, and speculate itself.

In conclusion, we submit that the decision of the Circuit Court of Appeals should be affirmed.

ROBERT J. PLEUS,
Attorney for Respondent,
Orlando, Florida.